

growth in gross private domestic investment of 27.5 percent for the first eight quarters of the current recovery has far exceeded the average of 13.5 percent over the six preceeding recoveries while growth in consumption remains only slightly above average. Most of the growth in investment has stemmed from strong growth in investment in nonresidential equipment while investment in structures has only marginally improved. Growth in investment in nonresidential equipment has reached 19.1 percent, substantially higher than the average of 5.7 percent over the six preceeding recoveries. Conversely, growth in investment in nonresidential structures increased 7.2 percent over the current recovery compared to an average of 3.2 over the six preceeding recoveries. Total consumption, on the other hand, has experienced growth rates of only 5 percent, only slightly above the average of 4.2 percent over the six preceeding recoveries. Consequently, it appears that investment and not consumption has led the current recovery.

Table 1
Growth in Components of GNP
Over First Eight Quarter of Recovery

	Average of Six Preceeding Recoveries	Current Recovery
GNP	5.2	6.0
Consumption	4.2	5.0
Durable	6.5	12.0
Nondurable	3.4	4.2
Services	3.6	3.3
Gross Private Domestic Investment ^{1/}	13.5	27.5
Fixed Investment	6.7	16.5
Residential	11.5	21.1
Nonresidential	5.5	15.4
Equipment	5.9	19.1
Structures	3.2	7.2
Government Purchases	4.8	1.7
State Local	3.7	1.7
Federal	5.9	1.7
Exports	9.6	6.5
Imports	12.0	16.6

^{1/} Gross Private Domestic Investment includes change in inventories, growth rates for inventory changes cannot be computed.

Note: Current Recovery: 82:4 to 84:4
Previous Recoveries: 49:4 to 51:4, 54:2 to 56:2, 58:1 to 60:1, 60:4 to 62:4, 69:4 to 71:4, 75:1 to 77:1, 82:4 to 84:4.

In contrast, looking at each component as a percent of GNP a different conclusion can be drawn. As a percent of GNP consumption and not investment has been the driving force of the recent expansion. Consumption has increased to 65.4 percent of GNP compared to an average of 61.4 over the six preceeding recoveries; a gain of 3.8 percentage points. The majority of this increase has been in durables and services. Gross private domestic investment also increased as a percent of GNP, but it recorded a gain of only 0.9 percentage points over the average of 15.6 percent. In this instance, as a percent of GNP, consumption not investment, has dominated the recent expansion.

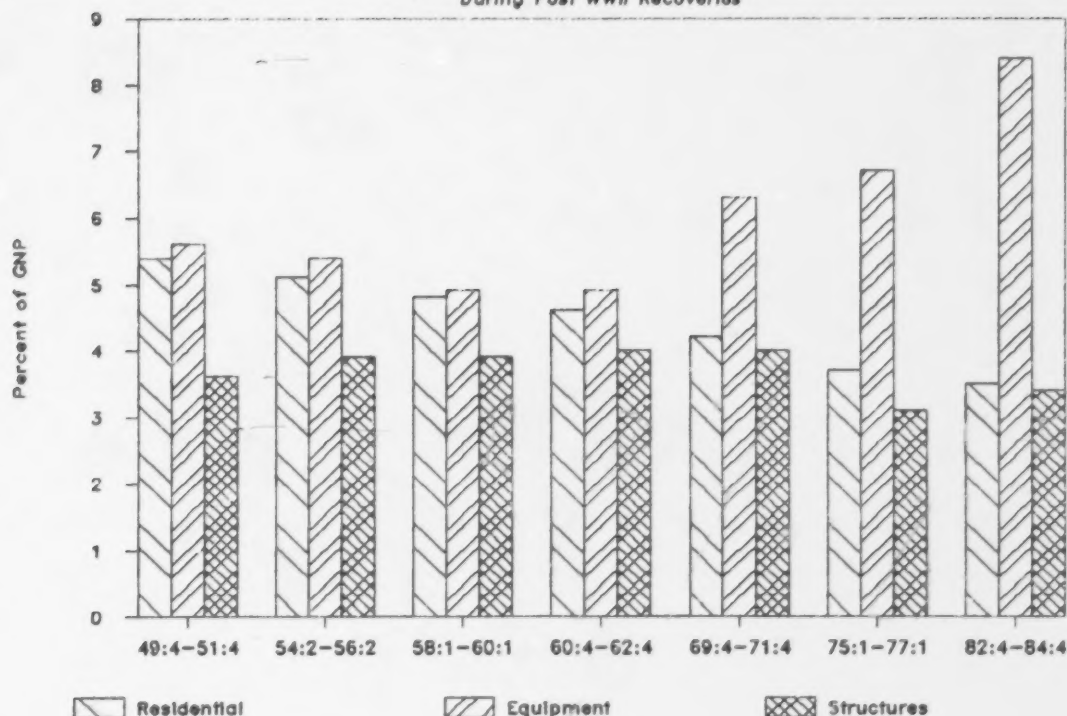
There have been significant changes in the composition of gross fixed investment during the current recovery. Evidence of this is a sharp increase in nonresidential investment in equipment as a percent of GNP while residential investment and investment in nonresidential structures actually declined as a percent of GNP. The decline in investment in nonresidential structures to 3.4 percent of GNP compared to an average of 3.7 percent over the six preceeding recoveries reflects the adverse effects high real interest rates had during the current recovery. In addition, a decline in residential investment to 3.5 percent of GNP compared to an average of 4.5 percent over the six preceeding recoveries underscores the low levels of residential investment that have occurred during the last recession. In summary, short-lived assets have dominated during the current recovery while long-lived assets declined.

Table 2
Impact of the Current and Past Economic
Recoveries on Consumption and Investment

	Percent of GNP	
	Average of Six Preceeding Recoveries	Current Recovery
Real GNP	---	---
Consumption	61.6	65.4
Durables	7.7	10.4
Nondurables	25.6	24.3
Services	26.2	30.6
Gross Private Fixed Investment	13.9	15.1
Inventories Change	0.6	0.4
Residential	4.5	3.2
Nonresidential	9.4	11.9
Structures	3.7	~~3.5~~
Equipment	5.7	8.4
Imports	5.7	10.7
Exports	6.3	10.0
Government Purchases	20.8	21.2
Federal	10.3	8.7
State	10.5	12.5

Note: Current Recovery: 82:4 to 84:4
Previous Recoveries: 49:4 to 51:4, 54:2 to 56:2, 58:1 to 60:1, 60:4 to 62:4, 69:4 to 71:4, 75:1 to 77:1, 82:4 to 84:4.

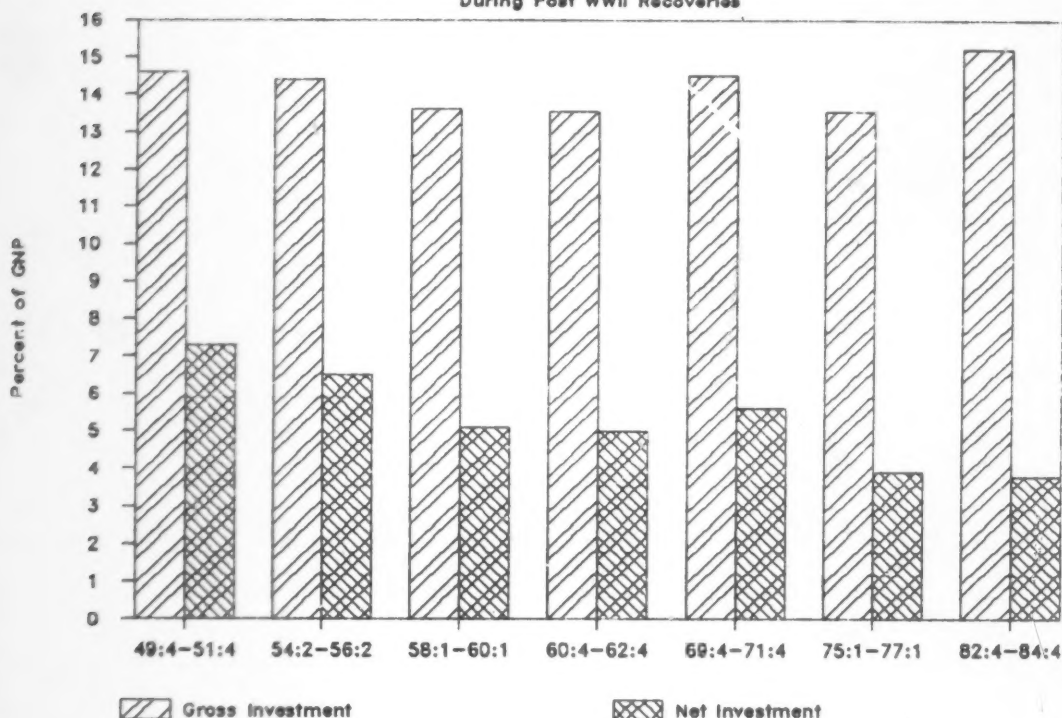
Figure 1
Components of Fixed Investment
During Post WWII Recoveries



It is important to note that while the level of gross investment as a percent of GNP has increased, the level of net investment (gross investment minus depreciation) has declined as a percent of GNP (Figure 2). This is due to the shift in investment toward shorter-lived assets which depreciate more rapidly. Thus, as a greater proportion of total investment is concentrated in the shorter lived equipment, the amount of net additions to the capital stock is diminished. Of the two measures, net investment is the most important indicator for future economic growth.

Figure 2

Gross Versus Net¹ Business Fixed Investment
During Post WWII Recoveries



^{1/}Net Investment equals Gross Investment minus capital consumption allowance with adjustment.

A third and more revealing method of analysis examines how much each component actually contributed to real output growth over the first eight quarters of the recovery. At first glance using this analysis (Table 3) it appears that investment as measured by Gross Private Domestic Investment has contributed more to GNP growth than consumption. However, total gross private domestic investment includes both fixed investment and changes in inventories. Of the two, changes in inventories have contributed 21.3 percent to real output growth and account for over a third of the contribution of gross private domestic investment. Thus, fixed investment, which consists of both residential and nonresidential investment, has contributed only 39.7 percent to growth in real GNP, substantially less than the 55 percent contribution by consumption. Confirming earlier analysis, nonresidential equipment investment continues to dominate fixed investment, contributing 24.8 percent to GNP growth while structures contributed just 4.2 percent to GNP growth over the recent expansion. Residential investment contributed just 10.7 percent to GNP growth during the current recovery, down from 11.8 percent during the six preceeding recoveries.

Table 3
Contribution to GNP Growth By Each Component of GNP

	Average of Six Preceding Recoveries	Current Recovery
Consumption	55.2	55.0
Durables	12.5	20.3
Nondurables	19.8	17.3
Services	24.4	17.2
Gross Private Domestic Investment	32.8	61.0
Fixed Investment	19.3	39.7
Residential	11.8	10.4
Nonresidential	10.0	29.3
Equipment	6.1	25.1
Structures	1.3	4.2
Inventory change	13.6	21.3
Government Purchases	12.6	5.5
State & Local	9.8	3.3
Federal	18.4	2.3
Exports	5.3	5.2
Imports	-6.2	-26.7

In summary, two of the three analysis clearly indicates that consumption and not fixed investment has been the driving force of the recent expansion. In addition, any growth that has occurred in investment has resulted from increases in the shorter lived equipment with both structures and residential investment only showing modest gains due to their greater sensitivity to high real interest rates which have existed during the recent expansion and the 1981 tax law changes which resulted in a subsidy for equipment but retained a relatively high tax rate on structures.

Table 4
U.S. ECONOMIC OUTLOOK

MARCH 1985

	QUARTERS								YEARS					
	Actual	Forecast							Actual	Forecast				
		84:4	85:1	85:2	85:3	85:4	86:1	86:2		86:3	1983	1984	1985	1986
AGGREGATE ECONOMY														
Gross National Product (\$ billions)	3,764	3,830	3,884	3,937	3,993	4,041	4,085	4,130	3,305	3,664	3,911	4,113	4,404	
Percent Change	7.8	7.2	5.8	5.6	5.8	4.9	4.5	4.5	7.7	10.9	6.7	5.2	7.1	
Percent Change (without inflation)	4.9	3.0	3.2	2.9	2.7	1.8	1.3	1.1	3.7	6.9	3.4	2.1	3.0	
Consumption	3.6	5.6	3.8	4.1	3.3	2.8	2.8	2.4	4.8	5.3	4.1	3.0	2.8	
Durables	12.7	11.9	7.5	7.2	4.7	2.9	3.0	1.9	12.1	13.0	8.1	3.8	3.3	
Nondurables	0.5	4.7	3.4	3.6	3.1	2.6	2.6	2.3	3.7	4.6	2.8	2.8	2.5	
Services	3.8	4.0	2.9	3.3	2.9	2.9	2.7	2.7	3.4	3.3	3.6	2.8	2.9	
Residential Investment	-5.2	5.8	8.6	15.0	-1.2	-4.2	-2.1	0.5	41.7	12.2	3.2	0.6	-0.1	
Nonresidential Investment	6.3	2.9	6.0	6.4	6.9	6.5	6.2	5.8	2.5	19.6	7.1	6.3	6.4	
Structures	18.8	-0.4	5.7	4.4	3.4	2.4	2.5	2.2	-7.8	15.7	6.5	3.1	3.5	
Equipment	1.9	4.1	6.1	7.2	5.2	8.0	7.7	7.1	7.3	21.3	7.4	7.6	7.5	
Exports	2.2	5.5	3.6	3.6	4.4	4.7	6.0	7.0	-5.6	4.9	4.1	5.2	7.3	
Imports	-31.9	12.8	12.1	12.7	11.8	10.3	8.6	6.7	7.6	26.5	6.2	9.9	6.0	
Government Purchases	6.3	5.0	2.3	4.3	1.3	1.4	0.0	2.6	-0.3	3.5	5.2	1.6	1.4	
Consumption (% of GNP)	64.6	65.0	65.1	65.3	65.4	65.5	65.8	66.0	65.8	64.8	65.2	65.8	65.7	
Residential Investment (% of GNP)	3.6	3.6	3.6	3.7	3.7	3.6	3.8	3.6	3.5	3.7	3.7	3.6	3.5	
Nonresidential Investment (% of GNP)	12.8	12.8	12.9	13.0	13.1	13.2	13.4	13.6	11.1	12.5	12.9	13.5	13.9	
Structures (% of GNP)	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.2	3.5	3.6	3.6	3.6	
Equipment (% of GNP)	9.2	9.2	9.3	9.4	9.5	9.6	9.8	9.9	7.9	9.0	9.3	9.9	10.3	
Inventory Change (\$ billions)	35.3	26.4	26.8	16.9	19.8	17.0	7.8	-9.8	-13.5	57.9	22.5	2.4	3.8	
Mfg. Capacity Utilization Rate (%)	82	82	83	82	82	82	82	82	75	82	82	82	83	
Auto. Sales (millions of units)	10.2	10.9	10.8	11.0	11.0	10.9	10.9	10.9	9.2	10.4	10.9	10.9	10.9	
Domestic (% of total)	72.9	77.3	77.5	73.9	72.6	71.1	69.9	68.9	74.0	76.4	75.3	69.4	67.9	
Imported (% of total)	27.1	22.7	22.5	26.1	27.4	28.9	30.1	31.1	26.0	23.6	24.7	30.6	32.1	
Manufacturing Industrial Production (% change)	-0.5	5.2	4.3	2.9	3.0	1.4	2.0	2.1	7.8	11.2	3.9	2.4	4.7	
Common Market	2.3	1.0	2.5	4.2	3.1	1.5	2.9	1.1	0.8	3.1	2.7	2.4	1.3	
Japan	12.0	7.2	3.1	4.2	1.4	3.6	3.5	3.8	3.5	11.1	6.6	2.9	1.5	
Employment (millions) (civilian:household basis)	106.0	106.6	107.1	107.7	108.1	108.4	108.7	108.8	100.8	105.0	107.4	108.7	110.7	
Percent Change	2.5	2.3	2.2	1.9	1.7	1.1	0.8	0.6	1.3	4.1	2.3	1.3	1.8	
Unemployment Rate (%) (civilian)	7.2	7.3	7.2	7.2	7.3	7.3	7.5	7.7	9.6	7.5	7.2	7.6	7.7	
Personal Income per Household (average)<1>	39,487	40,100	40,463	40,926	41,399	41,926	42,404	42,831	35,415	38,535	40,722	42,615	45,204	
Percent Change -- Year Ago (w/o inflation)	4.9	3.8	2.7	2.4	2.0	1.7	1.6	1.2	1.5	5.4	2.7	1.4	2.0	
Personal Taxes per Household (average)	7,158	7,345	7,423	7,519	7,621	7,737	7,836	7,933	6,478	6,955	7,477	7,890	8,392	
Percent Change -- Year Ago (w/o inflation)	5.6	5.3	4.2	3.9	3.3	2.5	2.6	2.3	-3.0	3.4	4.2	2.4	2.3	
Percent of Personal Income	18.9	19.2	19.2	19.2	19.2	19.3	19.3	19.4	19.1	18.8	19.2	19.4	19.4	
Disposable Income per Household (average)	32,328	32,755	33,040	33,407	33,778	34,190	34,566	34,898	28,938	31,581	33,245	34,726	36,812	
Percent Change--Year Ago (w/o inflation)	4.7	3.5	2.5	2.2	1.9	1.6	1.5	1.1	2.5	5.8	2.5	1.2	1.9	
Household Interest Payments (% of total)	10.4	10.3	10.4	10.7	10.8	10.7	10.7	10.8	9.8	10.4	10.6	10.7	9.9	
Net Worth Per Household (average)	79,983	81,895	83,729	85,448	86,767	88,752	90,116	91,549	73,840	77,668	84,460	90,722	96,889	
Percent Change--Year Ago (w/o inflation)	2.7	4.7	6.0	5.5	5.3	5.4	4.6	3.9	7.6	1.4	5.4	4.2	2.7	
Consumer Price Inflation (CPI)	3.9	2.9	3.3	3.2	3.3	3.6	3.7	3.8	3.2	4.2	3.4	3.6	4.3	
Gross National Product Inflation (GNP Deflator)	2.8	4.1	2.5	2.7	2.9	3.0	3.1	3.4	3.8	3.8	3.2	3.0	3.9	
Personal Consumption Inflation	2.6	2.3	2.4	2.6	2.9	3.3	3.5	3.6	3.7	3.2	2.7	3.2	4.0	
Residential Construction Inflation	-0.3	1.6	2.3	2.5	3.0	3.7	4.1	4.1	1.7	3.8	2.5	3.5	4.6	
Nonresidential Construction Inflation	0.5	0.6	1.5	2.2	3.0	3.9	4.2	4.2	-1.0	0.3	1.3	3.5	4.7	
Producers Price Inflation (WPI)	0.5	-0.3	0.8	1.1	2.0	2.2	2.4	2.9	1.3	2.4	0.5	2.1	3.5	
Compensation per Manhour (% change)	3.3	5.5	3.5	3.7	4.3	5.3	4.4	4.5	4.8	4.2	4.1	4.5	5.3	
Productivity (% change)	1.5	1.6	1.6	2.0	1.8	1.4	1.2	1.5	3.4	2.7	1.5	1.6	1.8	
Unit Labor Cost (% change)	1.8	3.7	1.8	1.6	2.4	3.9	3.1	2.9	1.3	1.5	2.5	2.9	3.5	
Unit Capital Cost (% change)	4.3	4.1	3.9	3.5	3.1	2.8	2.5	2.3	6.9	4.6	3.7	2.4	1.8	
Before Tax Corporate Profits (\$ billions)<2>	243	240	245	243	245	242	238	232	213	245	243	237	258	
Corporate Tax Liability	95	93	94	93	94	94	93	89	86	98	93	92	103	
After Tax Profits	148	147	151	150	151	147	146	143	127	148	150	145	155	
Inventory Valuation Adjustment	-3	0	-3	-6	-9	-11	-12	-14	-11	-6	-5	-13	-20	
Capital Consumption Adjustment	64	70	75	81	87	89	92	93	33	56	78	93	90	
Profits from Current Production (with IVA, CCA)	209	217	224	225	228	225	226	222	149	197	224	224	226	
Adjusted for Inflation (84:3 base)	208	214	219	218	220	215	214	209	156	198	218	212	205	
Percent Change - Year Ago	14.9	13.6	11.1	9.3	5.9	0.9	-2.2	-4.1	46.0	27.3	9.9	-2.6	-3.2	
Per Unit of Output (% of GNP)	5.6	5.7	5.8	5.7	5.7	5.6	5.5	5.4	4.5	5.4	5.7	5.5	5.1	
Effective Corporate Tax Rate (%)<2>	30	29	29	28	28	29	28	28	34	32	28	28	31	
Federal Tax Receipts (Unified basis)	665	659	844	754	696	685	928	764	613	683	738	776	835	
Percent of GNP	17.7	17.2	21.7	19.1	17.4	16.9	22.7	18.5	18.6	18.6	18.9	18.9	19.0	
Federal Expenditures (Unified basis)	954	940	947	934	967	985	992	997	803	868	947	997	1,065	
Percent of GNP	25.4	24.5	24.4	23.7	24.2	24.4	24.3	24.1	24.3	23.7	24.2	24.2	24.2	
Surplus or Deficit (Unified basis)	-290	-281	-103	-180	-271	-300	-64	-233	-190	-184	-209	-221	-230	
% of GNP	7.7	7.3	2.6	4.6	6.8	7.4	1.6	5.7	5.8	5.0	5.3	5.4	5.2	
% of Personal Savings	174.7	178.6	69.4	126.2	194.3	213.9	46.3	177.4	158.1	116.3	142.1	165.4	154.6	
% of Net Domestic Savings	83.5	81.3	29.9	53.7	81.2	92.2	19.8	75.8	80.0	56.1	61.5	70.4	69.7	
<1> Includes personal contributions for social insurance.														
<2> Adjusted to include impact of windfall profits tax on domestic crude oil production.														

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Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach, and Janemarie Mulvey.

Table 5
REAL ESTATE AND FINANCIAL MARKETS

MARCH 1985

	QUARTERS								YEARS				
	Actual	Forecast							Actual	Forecast			
	84:4	85:1	85:2	85:3	85:4	86:1	86:2	86:3	1983	1984	1985	1986	1987
REAL ESTATE MARKETS													
Total Single-Family Home Sales (thousands)	3,817	4,181	4,347	4,446	4,307	4,239	4,129	4,019	3,751	3,933	4,319	4,075	3,838
(single-family resales and completions)													
Percent Change - Year Ago	0.7	0.4	7.1	19.5	12.8	2.1	-5.0	-9.6	42.4	4.9	9.6	-5.5	-5.8
Existing Single-Family Home Sales (thousands)	2,813	3,099	3,199	3,299	3,198	3,150	3,050	2,950	2,716	2,866	3,199	3,000	2,783
Percent Change - Year Ago	1.0	6.3	7.6	19.4	13.7	1.7	-4.7	-10.6	36.5	5.5	11.6	-6.2	-7.2
Dollar Volume (billions)	242.2	268.6	281.9	291.3	276.0	277.3	274.7	267.8	224.2	247.1	279.5	268.2	257.3
Existing Home Prices - Median (\$1000's)	72.0	73.6	75.4	76.0	74.6	76.4	78.4	79.2	69.8	72.3	74.9	77.9	81.0
Percent Change - Year Ago	2.8	3.2	3.7	3.8	3.7	3.8	4.0	4.2	3.2	3.5	3.6	4.0	4.0
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	656	638	639	649	646	662	689	701	633	665	643	686	722
Percent of Household Income	21	20	20	20	20	20	20	21	22	22	20	20	20
Private Housing Starts (thousands)	1,586	1,738	1,843	1,835	1,791	1,790	1,784	1,777	1,704	1,764	1,802	1,780	1,746
Percent Change - Year Ago	-6.6	-10.7	-0.8	10.3	12.9	3.0	-3.2	-3.2	61.3	3.5	2.2	-1.2	-1.9
Single-Family	1,035	1,085	1,183	1,183	1,143	1,122	1,112	1,102	1,066	1,100	1,149	1,108	1,088
Percent of Total	65.3	62.4	64.2	64.5	63.8	62.7	62.3	62.0	62.6	62.4	63.7	62.3	62.3
Multi-Family	551	654	660	652	648	668	672	675	637	664	653	672	658
Percent of Total	34.7	37.6	35.8	35.5	36.2	37.3	37.7	38.0	37.4	37.6	36.3	37.7	37.7
Mobile Home Shipments	291	303	314	320	324	328	335	333	286	294	315	332	329
New Single-Family Home Sales (thousands)	617	629	660	689	676	660	650	640	626	639	664	645	635
Percent Change - Year Ago	-6.1	-9.1	4.3	12.3	9.9	5.0	-1.6	-7.2	50.1	2.0	3.9	-2.9	-1.5
New Home Prices - Median (\$1000's)	79.5	80.0	80.7	81.5	82.3	83.2	84.3	85.4	75.5	79.8	81.1	84.9	89.6
Percent Change - Year Ago	4.8	2.7	0.3	0.1	3.5	4.0	4.4	4.8	8.9	5.8	1.6	4.6	5.6
New Home Prices - Mean (\$1000's, Quality Adjusted)	95.0	94.8	95.3	96.5	97.2	97.5	98.4	100.1	89.7	93.6	96.0	99.3	103.8
Percent Change - Year Ago	5.3	4.2	2.0	1.5	2.3	2.9	3.3	3.7	2.1	4.4	2.5	3.5	4.6
NAR Affordability Index													
	86.2	88.0	87.9	90.5	89.9	90.3	87.0	88.0	82.0	86.2	89.1	89.5	89.0
New Mortgage Commitments (\$ billions)	181.6	182.7	188.4	194.4	199.3	209.2	206.8	204.5	163.4	189.5	191.2	204.4	199.0
Percent Change - Year Ago	10.7	-4.4	-8.8	8.7	9.9	14.5	9.8	5.2	152.1	16.0	0.9	6.9	-2.6
Mortgage Debt Outstanding (\$ billions)	2,033	2,127	2,223	2,312	2,403	2,330	2,287	2,262	1,752	1,953	2,266	2,283	2,273
Homeowners' Equity (\$ billions)<1>	1,479	1,492	1,505	1,522	1,510	1,561	1,564	1,610	1,554	1,504	1,515	1,598	1,702
Housing Inventory (millions)	91.7	92.0	92.4	92.8	93.1	93.5	93.9	94.3	89.6	91.1	92.6	94.1	95.8
Rental Vacancy Rate (%)	6.3	6.2	6.1	5.9	5.8	5.8	5.8	5.8	5.6	5.9	6.0	5.8	5.8
Unsold New Homes (% of sales)	55.7	54.1	56.4	60.1	64.1	63.7	63.6	60.6	43.0	50.6	58.7	61.7	53.8
Office Vacancy Rate (%)<2>	14.7	10.7	10.4	10.1	9.3	9.7	9.5	9.4	11.7	13.9	10.3	9.5	9.1
Industrial Vacancy Rate (%)<2>	4.7	4.0	3.9	3.8	3.6	3.7	3.7	3.6	4.9	4.7	3.9	3.6	3.4
New Commercial Building Construction (% Ch Value)	56.0	-0.8	3.5	3.3	3.0	-0.6	-6.1	-5.5	-4.2	37.4	13.8	-1.5	0.8
New Industrial Building Construction (% Ch Value)	27.4	8.5	25.3	17.6	28.2	21.6	16.1	11.9	-25.7	11.9	17.3	20.1	18.3
FINANCIAL MARKETS													
Money Supply													
M1 (% change)(FED Target 4-7%)	3.4	9.0	5.5	5.2	4.6	5.4	5.1	5.7	11.2	6.9	5.8	5.2	5.3
M1 Velocity (% change)	4.2	-1.7	0.2	0.4	1.1	-0.5	-0.6	-1.1	-3.2	3.7	0.9	0.0	1.6
M2 (% change)(FED Target 6-9%)	9.3	14.3	6.1	5.1	5.4	5.7	7.6	7.6	12.6	7.7	8.7	6.2	6.5
M2 Velocity (% change)	-1.4	-6.2	-0.3	0.5	0.4	-0.8	-2.9	-2.9	-4.4	3.0	-1.8	-1.0	0.5
Monetary Base (% change)	4.5	10.8	3.8	4.8	5.0	5.3	5.1	4.8	9.5	6.1	6.5	5.0	5.7
Flow of Funds (BIA Basis)													
Sources (total: gross savings)	655	632	662	663	676	687	696	690	479	654	663	694	753
Private													
Personal Savings	166	157	148	142	140	141	137	132	118	137	147	134	148
Savings Rate	6.3	5.9	5.4	5.2	5.0	5.0	4.8	4.5	5.0	6.1	5.4	4.7	4.8
Gross Business Savings	540	552	562	567	574	576	582	585	454	520	564	584	615
Government													
Federal	-195	-196	-198	-203	-206	-203	-208	-214	-179	-175	-201	-209	-218
State and Local	55	56	59	57	58	55	56	53	44	53	57	55	62
Foreign (current account deficit)	90	83	90	99	110	119	128	134	42	100	96	130	145
Uses (total: gross investment)	634	632	644	650	663	671	673	668	472	637	647	675	735
Nonresidential Investment													
Equipment	288	291	296	302	310	317	326	334	223	275	300	330	367
Structures	158	158	161	164	166	169	172	175	130	150	162	173	188
Residential Investment	153	156	160	167	168	167	168	170	132	154	163	169	177
Inventory Investment	35	26	27	17	20	17	8	-10	-13	58	22	2	4
Value of the U.S. Dollar (Weighted by Trade) (Base-1967)	1,143	1,189	1,200	1,173	1,145	1,120	1,100	1,081	1,024	1,095	1,177	1,092	1,032
Percent Change	8.9	17.1	3.7	-8.8	-9.2	-8.4	-7.1	-6.4	3.7	6.9	7.5	-7.2	-5.5
Selected Interest Rates (Percent)													
Mortgage Commitment Rates													
30 Year, Fixed-Rate	14.0	13.3	12.9	12.9	13.2	13.2	13.4	13.5	13.9	14.2	13.1	13.4	13.7
Real Mortgage Rate (30 yr. avg. is 4.5%)	11.3	9.2	10.5	10.4	10.4	10.3	10.4	10.2	10.2	10.5	10.1	10.2	9.5
1 Year ARM (without buy-down)	11.7	10.7	11.0	11.1	11.1	11.3	11.4	11.5	11.3	12.6	11.0	11.4	12.2
Real Mortgage Rate	9.0	6.6	8.5	8.4	8.2	8.3	8.3	8.1	7.5	9.0	7.9	8.1	8.0
Corporate Bond Rate (AAA)	12.3	11.9	11.1	11.1	10.8	10.9	10.7	11.0	12.0	12.7	11.2	10.9	11.2
Government Bond Rate	11.8	11.5	11.1	11.0	10.7	10.7	10.5	10.5	11.3	12.5	11.1	10.5	10.8
Real Government Bond Rate (30 yr. avg. is 2.1%)	9.0	7.4	8.6	8.3	7.7	7.7	7.3	7.1	7.6	8.9	8.0	7.1	6.6
Federal Funds Rate	9.3	8.2	8.5	8.8	9.2	9.5	9.7	9.8	9.1	10.2	8.7	9.8	10.9
3 Month Treasury Bill Rate	8.8	7.9	8.2	8.3	8.5	8.7	8.8	8.9	8.6	9.5	8.2	8.9	9.6
Real 3 Month T-Bill Rate (30 yr. avg. is 1.2%)	6.1	3.8	5.7	5.7	5.5	5.7	5.7	5.5	4.8	5.9	5.2	5.5	5.5
1 Year Treasury Bill Rate	10.0	9.0	9.3	9.4	9.4	9.6	9.7	9.8	9.6	10.9	9.3	9.7	10.3
Real 1 Year T-Bill Rate (30 yr. avg. is 1.7%)	7.3	4.9	6.8	6.7	6.5	6.6	6.6	6.4	5.8	7.3	6.2	6.4	6.3
Commercial Paper Rate	9.2	8.1	8.5	8.6	9.1	9.3	9.5	9.7	8.9	10.1	8.6	9.6	10.8
Rate on Money Market Fund Shares	9.3	8.3	8.7	8.9	9.2	9.5	9.6	9.8	9.0	10.3	8.8	9.7	10.8
Prime Rate	11.8	10.5	10.5	10.6	10.9	11.3	11.4	11.7	10.8	12.0	10.6	11.5	12.5
<1> Homeowners Equity has been adjusted to correspond to the Federal Reserve's Flow of Funds data.													
<2> Historical data courtesy of Coldwell Banker.													

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach and Janemarie Mulvey

OUTLOOK

FOR THE ECONOMY AND REAL ESTATE



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Outlook for the Economy and Real Estate

Aggregate Economy

As the recovery enters its 29th month, there is abundant evidence that it is losing its momentum and the economy has entered a period of below-average growth that should last about 12 to 15 months. In its "flash" estimate, the Commerce Department predicts that real or inflation-adjusted Gross National Product (GNP) increased at an annual rate of just 2.1 percent during the first three months of this year. This is a substantial drop from the 4.3 percent growth rate of the final quarter of 1984 and is due primarily to a surge in imports over the period. However, based on recent employment data it appears that economic activity picked up in March, suggesting that the first quarter growth rate will be revised upward to about 2.5 percent.

Consumption, which represents two-thirds of GNP, continues to be the driving force of the current expansion with particularly strong spending on consumer durables. Consumption expenditures are expected to have increased 5.8 percent during the first quarter compared to 3.6 percent during the previous quarter. Domestic automobile sales remain strong with mid-March sales at a seasonally-adjusted annual rate of 8.5 million units. However, this pace of consumer spending cannot be sustained as it exceeds growth in personal income. Consumers have reduced savings and added to existing debt to finance their purchases, suggesting a significant slow down in this type of spending over the remainder of 1985 and through 1986.

After weakening during the last half of 1984, residential investment is currently providing a substantial boost to GNP growth and should continue to do so for the next six months as homebuyers and builders respond to improved affordability. Total housing starts should reach a 1.8 million unit annual pace during the second and third quarter, then start dropping off modestly as long-term interest rates start edging up.

Business investment spending continues to soften, particularly inventory investment and construction of new commercial and industrial structures. After increasing nearly 16 percent in 1984, investment in new commercial and industrial structures should increase just 7 percent in 1985 as construction of new office space declines in response to high vacancy rates and construction of new retail space peaks. The pace of investment in new equipment is also slowing as businesses have scaled back their projected capacity requirements in response to the slowing economy. Moreover, the impact of this equipment investment on domestic output is declining as a growing share of this spending goes for imports.

The growing trade imbalance is putting a severe drag on economic growth. Despite some growth in exports, the overall level remains depressed as most of our trading partners continue to follow contractionary fiscal policies. At the same time the strong dollar and healthy levels of domestic spending encourage rapid growth of imports, resulting in a widening merchandise trade deficit. Frustration with our serious trade imbalance has led to some irresponsible "Japan bashing" and calls for retaliatory protectionist measures in the U.S. Senate. While it is certainly the case that Japanese markets are not as open to imports as are U.S. markets, the primary cause of the nearly \$40 billion U.S. trade deficit with Japan is the overvaluation of the U.S. dollar which is the result of the huge federal deficit.

Overall, real GNP should increase about 3 percent during the second quarter followed by declining growth rates thereafter. This expected increase in the growth rate is due primarily to the fact that there probably will not be a major increase in imports as occurred during the first quarter. By the end of 1985 real growth should be at about 2 percent, dropping below that level in 1986. The performance of the economy should then improve in 1987 as business investment picks up and the trade balance improves.

Employment and Inflation

Employment increased an estimated 2.6 percent during the first quarter, comparable to growth during the last quarter of 1984. Most of this growth in employment was in the service sector while manufacturing provided a relatively small share of employment growth. In March the civilian unemployment rate held steady at 7.3 percent as increases in the labor force matched increases in employment. As the economy slows over the remainder of 1985 and through 1986 the unemployment rate is expected to edge up into the 7 1/2 to 8 percent range as growth in the labor force outpaces increases in employment.

The inflation outlook remains optimistic as the Consumer Price Index (CPI) continues to increase at annual rates under 4 percent. In February the CPI increased 0.3 percent, resulting in a 3.5 percent increase over the last 12 months. The Producer Price Index for finished goods declined 0.1 percent resulting in an increase of just 0.7 percent in this index over the past 12 months. The index for crude goods fell 1.9 percent in February after falling 2.2 percent in January. Over the 12 month period ending in February this index fell 4.3 percent with most of this decrease occurring in nonfood materials used in manufacturing, including crude oil and metals. The softness in producer prices and continued modest increases in wage costs are expected to hold inflation under 4 percent through 1986. However, a sharper than expected decline in the dollar would likely result in more rapid inflation due to increased prices for imports and less competition for domestic producers.

Monetary Policy and Interest Rates

Both short- and long-term interest rates rose about 100 basis points (one percentage point) from late January through mid-March. This increase in rates appears to have been prompted by investor concern over reports of real GNP growth of 4 percent or more during the first quarter and fears of a tightening move by the Federal Open Market Committee (FOMC) of the Federal Reserve Board (FED) at its meeting on February 12-13. Since mid-to-late March short-term rates have fallen about 50 basis points and long-term rates about 25 basis points as it has become apparent that the economy is weaker than was generally believed and because of a lack of any evidence of a credit tightening policy change by the FED. Recently released minutes of the February FOMC meeting confirm that no tightening action was taken in light of continued low inflation and concerns about the strength of the dollar.

The available evidence suggests that short-term interest rates should soon start to rise again and should climb about 50 basis points by the end of the year due to increasing loan demand associated with moderate economic growth. Contributing to this relatively modest increase in short-term interest rates is the expectation that the FED will not tighten its credit stance due to continued low inflation, a strong dollar, and weakness in

several sectors of the economy such as agriculture and manufacturing. Long-term rates should continue to fall about another 25 basis points over the next several weeks and then remain fairly stable through the rest of the year as the supply of long-term funds keeps pace with demand and expectations of future inflation continue to slowly edge downward. Keep in mind that despite this expected stability of interest rates, real or inflation-adjusted interest rates remain two to four times higher than their average over the 30-year period from 1950 to 1980 due to the large and expanding federal deficit and the fact that because of this deficit monetary policy is tighter than it otherwise would need to be.

Since Chairman Volcker's appearances before Congress earlier this year, there has been some confusion in the financial press over the correct method of computing the upper and lower targets for the monetary aggregates (i.e., M1, M2, etc.). Traditionally, the FED has used the fourth quarter average actual level of the monetary aggregates, centered in November, as the base for computing the upper and lower target ranges for the following year. This procedure results in the familiar cone shape where the target range is very narrow in the beginning of the year and gets progressively larger as the year proceeds.

In his testimony, Chairman Volcker noted that M1, M2, and M3 were above their target ranges as expressed by the cone approach for the month of January but that he and other members of the FED were not overly concerned, implying that the FED saw no immediate need to take corrective actions. The stated reason for this lack of concern was that in the early part of the year the target range is very narrow, leaving little leeway for variations in growth rates. Volcker referred to an alternative method of computing the target ranges called the "tunnel" or "parallel band" approach. Using the same base as the cone approach, a growth line based on the mid-point of the target range (5 1/2 percent for the 4 to 7 percent target range for M1) is computed through the end of the year. Then two parallel lines are drawn above and below the mid-point growth line representing the upper and lower target ranges. The target range at the end of the year is the same under both approaches, but under the parallel band approach the target range is equally spaced throughout the year. As shown in Diagram 1, through March of this year, M1 has been within its target range when expressed in this parallel band approach.

Another reason the FED has not tightened credit conditions in spite of very rapid money growth so far this year is that the base for the 1985 targets, the average actual level for the fourth quarter of 1984, was below the mid-point of the 1984 target level. Diagram 2 presents the 1985 target range for M1 based on the mid-point of the target for the fourth quarter of 1984. In this case M1 is well within the parallel band target range for 1985.

Diagram 1
1985 MONEY STOCK (M1) AND TARGETS

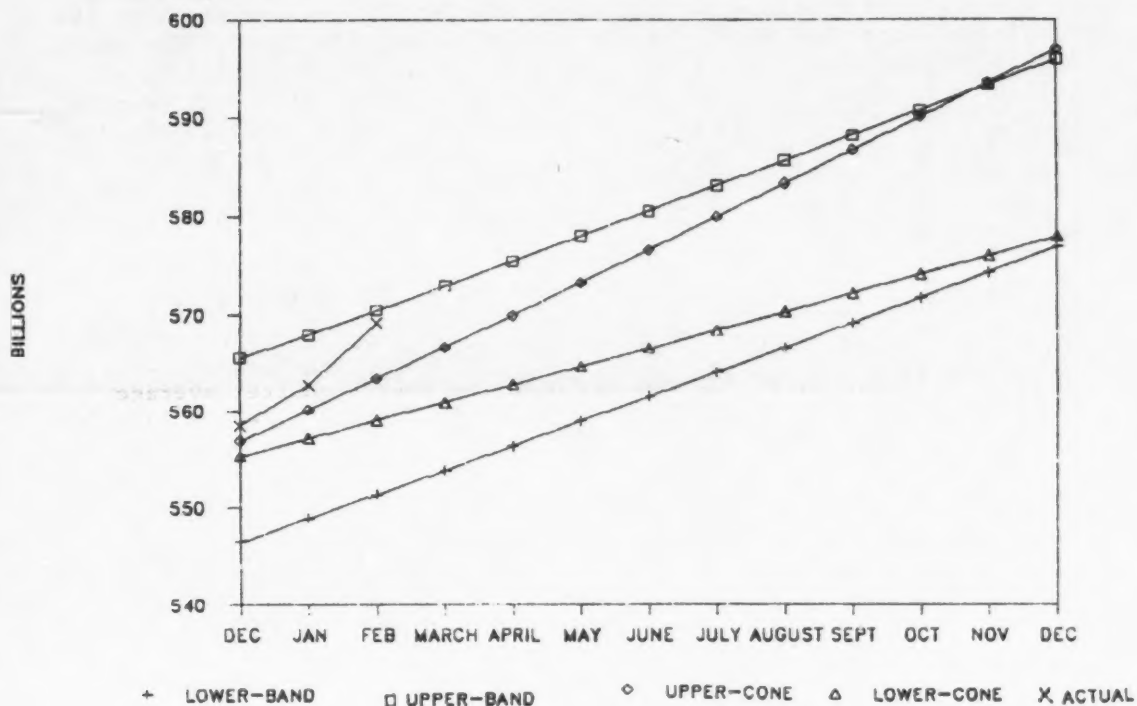
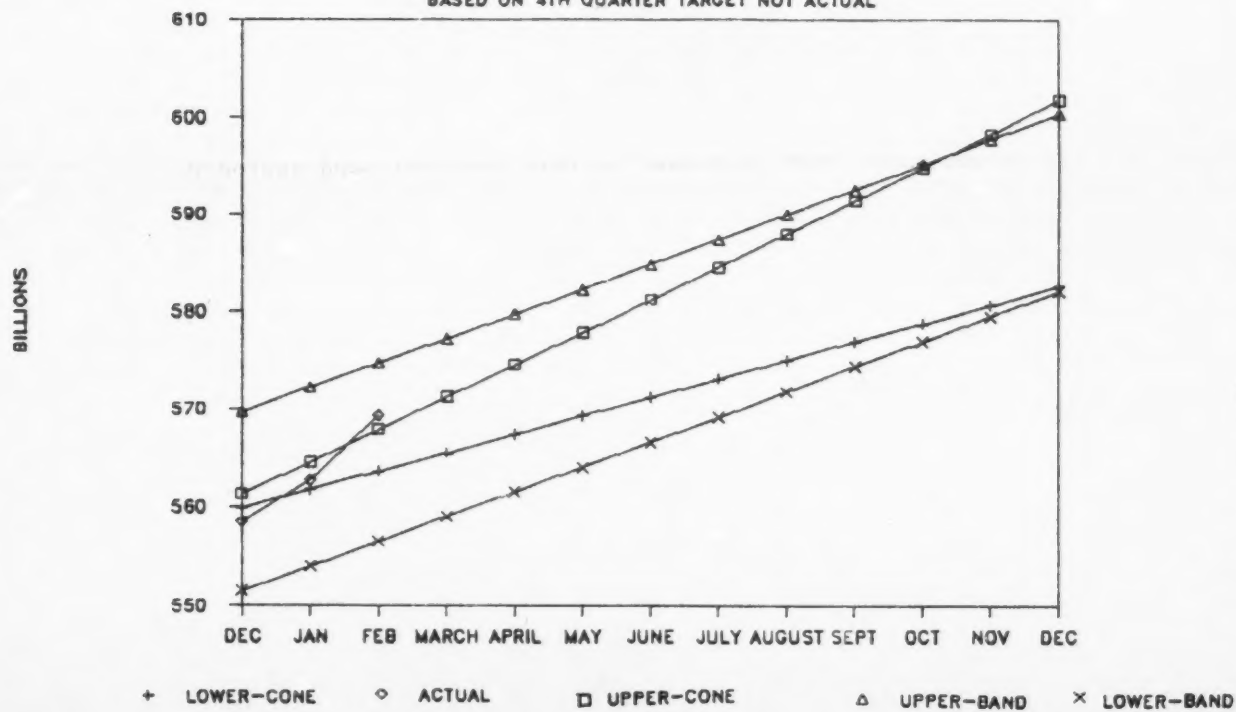


Diagram 2
1985 MONEY STOCK (M1) AND TARGETS

BASED ON 4TH QUARTER TARGET NOT ACTUAL



Fiscal Policy

With the White House and the Senate Republican leadership compromise on the federal budget there is hope that an end to the deficit stalemate is in sight. In fact, the mere announcement of the compromise resulted in a significant rally in the bond markets. The significance of this compromise is that it goes beyond the one-year "freeze" of federal spending, which would provide minimal deficit reduction, and recommends serious structural changes in federal spending. These changes include 3 percent real growth of defense spending and less than full CPI cost-of-living adjustments for entitlement programs, including social security. The result of these changes would be gradual reductions in federal spending as a percent of GNP, putting the federal budget on the path toward balance. Realistically, total elimination of the deficit would take eight to ten years under this approach. However, if enacted into law, it would provide immediate economic benefit which would grow more significant over time. As shown in Table 1, if enacted as the FY 1986 budget, by 1988 mortgage interest rates would likely be reduced by one full percentage point resulting in 150,000 additional housing starts, 300,000 additional existing home sales, 500,000 additional full-time jobs, and an additional \$350 in income for every household in the country. In ten years, mortgage interest rates would be about 2 1/4 percentage points lower, with significant increases in overall economic activity. Further, without the burden of financing today's huge deficits, a greater proportion of overall economic activity will go towards all forms of investment, further enhancing the nation's growth potential.